



Emerald Lakes, Tongariro National Park

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All on track

The highlight last week was the release of the *Quarterly Survey of Business Opinion* (QSBO). This venerable survey has been around since 1970. It gives the most reliable indication of the state of the economy in a given quarter, at least until the relevant GDP figures are released two and a half months later. Despite this pedigree, markets pay the QSBO precious little attention.

The September instalment of the QSBO served to confirm the basic narrative we've laid out regarding the New Zealand economy. First, the economy is in the grip of a substantial upswing. Second, the upturn is no longer confined to the construction industry, nor to Auckland and Canterbury – it is spreading across industries and regions. And third, the upswing will generate inflation pressures that will require the Reserve Bank to lift interest rates.

After thumbing through the detail of the survey, we have revised our forecast of September quarter GDP to 1.2%. That is made up of around 0.9% underlying growth, plus a substantial direct contribution from the agriculture sector, which is recovering rapidly from drought.

The survey also confirmed that inflation is low at present. Only a net 8% of firms reported that they had been able to raise prices in the last three months, and fewer firms reported rising costs. However, leading indicators of inflation generally tightened – firms are now operating closer to full capacity, are reporting more difficulty finding skilled or unskilled labour, and are more likely to say they intend to raise their prices over the next three months. We remain firmly convinced that the stage is being set for inflation to trend gradually higher. And that leaves us comfortable with our call that the first OCR hike will come in March next year.

While most news on the economy has been fairly positive, recently consumer spending has bucked that trend. Last week's Electronic Card Transactions data showed that the value of transactions fell 0.4% in the month of September. A single month's decline is nothing special. But it is clear that consumer spending has come off the boil over the past three months.

All on track continued

This matches the pullback in consumer confidence we observed a couple of weeks ago when we released the Westpac McDermott Miller Consumer Confidence Index. The striking feature of that survey was that respondents reported a shortage of disposable income. Petrol prices rose 5% over the September quarter, briefly reaching a new all-time record. We can surmise that higher petrol prices have dented consumers' budgets and soured their mood.

Higher petrol prices will also feature prominently in this week's inflation data. We estimate that consumer prices rose 0.9% in the September quarter. With a soft September 2012 quarter dropping out of the calculation, that would lift the annual inflation rate from 0.7% to 1.3%, bringing it back within the Reserve Bank's 1-3% target band for the first time since June 2012.

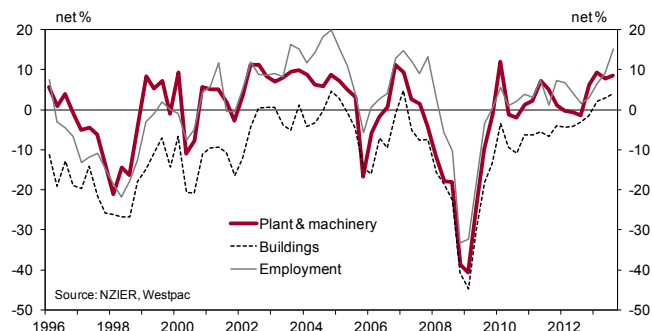
This will certainly be a sharp lift in the annual rate of inflation, but it overstates the trend. Fuel prices have fallen back in recent weeks, so December quarter inflation could be relatively weak. While the New Zealand dollar is no longer trending upward, the big lift of the past year will continue to constrain prices for a while yet. So we don't expect annual inflation will reach the RBNZ's target midpoint of 2% until the end of next year.

That said, having inflation back within the target band will be an important threshold – the RBNZ will feel more emboldened to discuss the likelihood that interest rates will need to rise.

The great unknown

The great unknown for the New Zealand economy is the effect of the Reserve Bank's Loan to Value Ratio mortgage lending restrictions, which came into force on October 1. Accordingly, we are keeping a close eye on the minutiae of the housing and mortgage lending data. To date, there has been no sign that the LVR restrictions are having an impact. The housing market data we've seen so far relates to the month of September, and has been as strong as ever. Mortgage approvals data up to October 4 show nothing untoward.

Investment and employment intentions (seasonally adjusted)



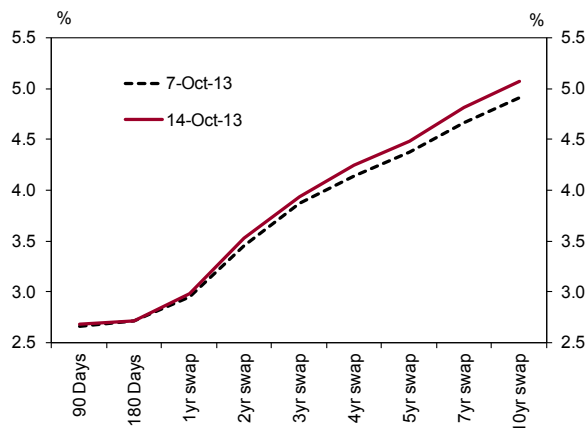
The lack of any impact at this stage is no surprise – it is far too early to draw any conclusions. Our view on the LVR restrictions is that they will deliver a short, sharp knock to the housing market (the recent sharp lift in fixed mortgage rates will have the same effect). But the time taken to complete housing transactions means the market is ponderously slow to respond. We wouldn't expect mortgage approvals to drop away until later in October. And as we've laid out in past Weekly Commentaries, we expect the timeline for the housing market will be a drop in turnover around November, followed by a modest slowdown in the rate of house price inflation from early 2014.

Fixed vs Floating for mortgages

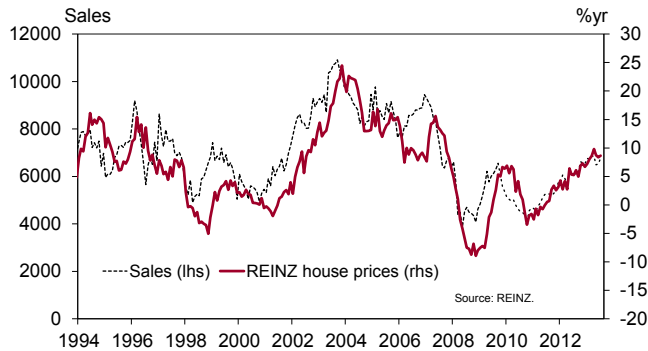
We are now indifferent between fixing and floating.

In our view, interest rate markets are now "fairly priced". We expect short-term rates to rise substantially over the next three years. The level of long-term fixed rates, which are higher than short-term rates, is in tune with that expectation. This means we can discern no obvious interest rate advantage in any particular term. The choice really comes down to individual circumstances and preferences.

NZ interest rates



REINZ house prices and sales

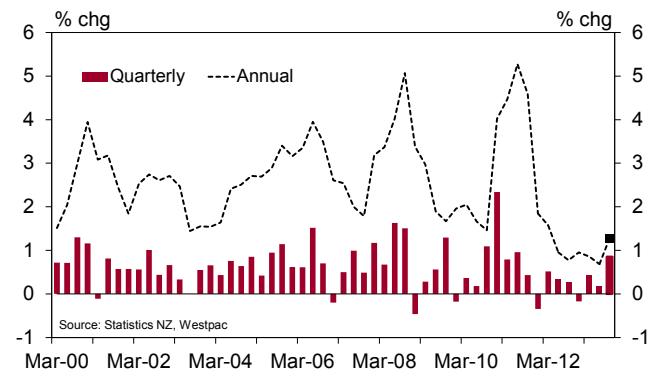


NZ Sep REINZ house prices and sales

Oct 14-18 (tbc), Sales last: -0.9%, Prices last: 9.5%yr

- The housing market has continued to power ahead over 2013, with sale prices up 9.5%yr in August, the second-fastest pace in the last six years.
- Indicators for September suggest another robust month. Mortgage approvals have picked up in the last two months, and figures from real estate agencies show a further lift in prices. Supply remains tight, but is starting to improve in Auckland.
- The RBNZ announced restrictions on high loan-to-value mortgage lending in mid-August, taking effect from 1 October. We have yet to see any impact in the data, nor would we expect to at this stage. The pipeline of approved loans will support sales for a bit longer, while any intention by buyers to 'beat the deadline' is likely to run up against a shortage of listings.

NZ CPI inflation

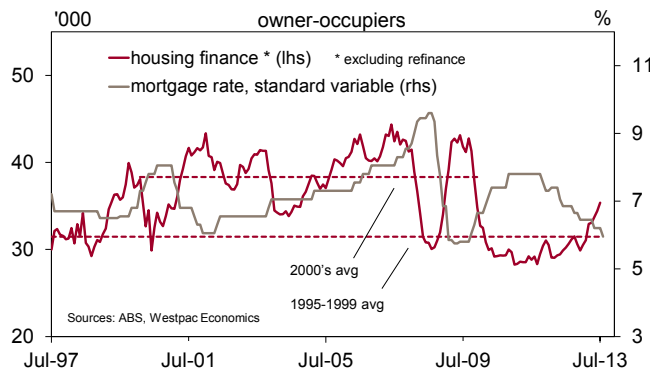


NZ Q3 CPI

Oct 16, Last: 0.2%, WBC f/c: 0.9%, mkt f/c: 0.8%

- We estimate that consumer prices rose 0.9% in the September quarter. With a soft September 2012 quarter dropping out of the calculation, that would lift the annual inflation rate from 0.7% to 1.3%, bringing it back within the RBNZ's 1-3% target band for the first time since June 2012.
- A spike in fuel prices is the main contributor to the lift in the annual inflation rate. Elsewhere, the degree of slack in the domestic economy and the legacy of a rising NZ dollar have kept price pressures subdued.
- We expect inflation to only gradually climb back to 2% by the end of next year. Nevertheless, a return to within the target range should leave the RBNZ more confident in its rhetoric that inflation is tracking higher and that higher interest rates will be warranted next year.

Owner-occupier finance & the rate cycle

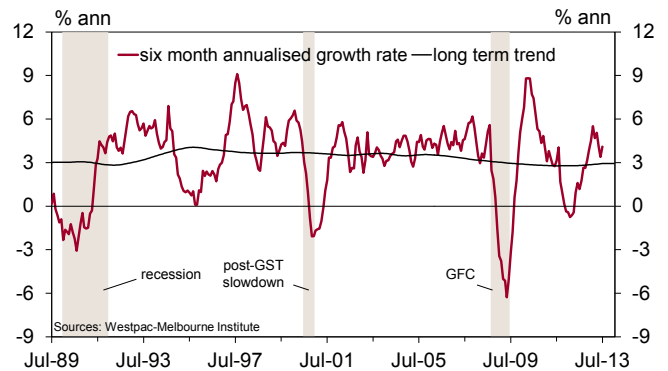


Aus Aug housing finance (no.)

**Oct 14, Last: 2.4%, WBC f/c: -2.0%
Mkt f/c: -2.5%, Range: -5.0% to 3.0%**

- The July housing finance report showed a consolidation in the solid but unspectacular upturn that began a year ago, with notable areas of softness around first home buyers and investor activity ex NSW. More recent data suggests Australia's housing recovery saw a significant step-up in momentum in August-September, with auction activity surging and signs of a pick-up in price growth.
- Despite this, industry data strongly suggests the August housing finance report will show a decline in the number of owner-occupier loan approvals – we expect a 2% fall. Investor loans may show a stronger picture. Note that technically this should also include loans to self-managed super funds. By definition though, housing finance approvals do not cover cash buyers or foreign buyers funding abroad.

Westpac-MI Leading Index

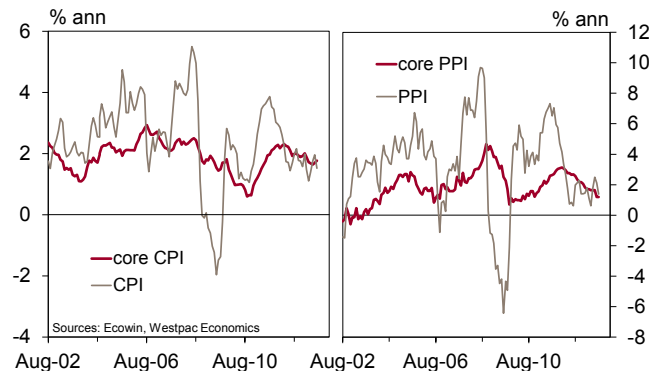


Aus Aug Westpac-MI Leading Index

Oct 16, Last: 4.1% annualised

- The growth rate in the Leading Index nudged higher in July from 3.4% to 4.1%. It is well off the 5.5% pace set earlier in the year, but still comfortably above its 2.9% long-run trend pace.
- The August reading will include updated monthly data on: equities (ASX +1.8% vs +5.4% in Jul); money supply (-0.4% vs +0.5% in Jul); dwelling approvals (-4.7% mth vs +10.2% mth in Jul); and US IP (+0.4% in Aug vs flat in Jul).

US price inflation



US Sep consumer price index

Oct 16, CPI: Last: 0.1%, WBC f/c: 0.1%

- The CPI rose 0.1% in Aug, both headline and core. Energy prices fell 0.3%, food rose 0.1%, and above-trend gains in rent (0.3%) and medical care (0.6%) were offset by flat auto prices and ongoing falls in airfares (-3.1%).
- Gasoline prices drifted lower in Sep, some of which is seasonal so not captured in the headline index. The August PPI revealed rising wholesale food prices which were not passed on to consumers that month, but could hit the Sep CPI.
- If, as we expect, medical care and owner rent revert to their recent trend pace of gain, the core CPI will print 0.1% again in Sep. Apparel and auto prices have not fallen since April/Feb respectively and pose further downside risk. The headline CPI should also print 0.1% if gasoline/food price shifts are offsetting. That would pull the annual rate down to 1.1%/yr, its equal lowest since the 2009 recession.

US housing starts & permits



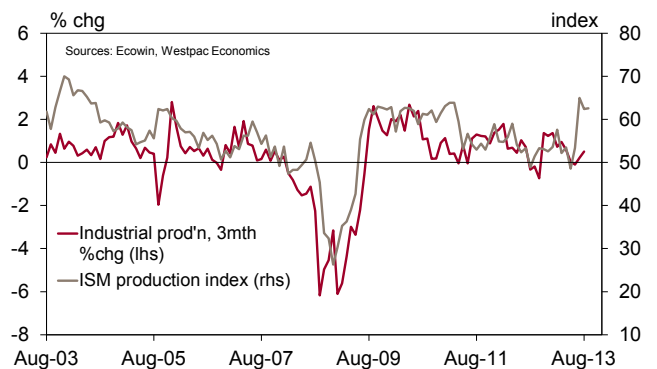
US Sep housing starts/permits

Oct 17, Housing starts: Last: 0.9%, WBC f/c: 3.0%

Oct 17, Housing permits: Last: -2.9%, WBC f/c: 3.0%

- Housing starts rose 0.9% in Aug but an 11% fall in volatile multiples masked a 7.0% jump in single-family starts, the fastest 1-month gain for the year so far. However, the annualised sales pace of 628k is still down 3.7% compared to Feb; single-family starts have fallen 10% since then, hardly evidence of a recovering housing market.
- Single-family permits rose 3% in Aug, just reversing their July fall; at 627k annualised, there is not much reason to expect significant further upside in starts in the near term.
- Indeed, housing activity in the remainder of this year will be constrained by the impact of higher borrowing costs. Volatile multiples will drive the headlines as usual, but we don't expect single starts (or permits) to repeat August's impressive gain.

US industrial sector



US Sep industrial production

Oct 17: Last: 0.4%, WBC f/c: 0.7%

- Industrial production rose a modest 0.4% in Aug; a 0.7% jump in factory output was led by autos (up 5%, reversing July's new model retooling drop). The factory gain was the fastest for the year so far, but the ex auto 3-month trend only stabilised from -0.2% in Mar-May to flat in Jun-Aug, despite a soaring ISM factory survey. Utilities lost 1.5%, their 5th straight fall.
- Factory hours worked data will not be available for Sep until the government shutdown is over. Auto sales were down 5% in the month; but in Aug, orders for autos rose 2.4%. Core capital goods orders had been rising steadily until June, but have pulled back since. The Sep ISM factory survey showed orders and production holding above 60 (i.e. strong!), but this signal has not been reflected in the Fed's IP data.
- Our Sep 0.7% IP forecast gain is supported by a jump in electricity utilities, but auto output swings are done for the year and ex auto manufacturing likely rose a mediocre 0.3%.

Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 14					
NZ	Sep REINZ house sales	-0.90%	-	-	Due this week. Impact of LVR limits unlikely to be seen at this stage.
	Sep REINZ house price index %yr	9.50%	-	-	Indicators suggest turnover and prices remained solid in Sep.
	Sep Performance of Services Index	53.2	-	-	Slowed in Aug after very strong readings through most of 2013.
Aus	Aug housing finance	1.50%	-2.5%	-2.0%	Industry figs point to decline despite pick up in housing market activity.
Eur	Aug industrial production %yr	-1.5%	0.60%	1.00%	German IP (ex construction) rose 2.1% in Aug after a 1.8% July fall.
	Eurozone Fin-Mins meeting	2.80%	-	-	Banking union the hot topic.
Can	Sep existing home sales	2.80%	-	-	Mar to Aug saw solid gains in sales after sombre 2012.
Tue 15					
Aus	RBA meeting minutes	-	-	-	Recent minutes have given critical insight into RBA's policy intentions.
Ger	Oct ZEW analysts' expectations	49.6	51	40	Sentix eurozone survey showed expectations slipping in Oct.
UK	Sep PPI %yr	1.00%	0.90%	-	Core output measure.
	Aug ONS house prices %yr	3.30%	-	-	July matched 3.3%yr in Dec, fastest pace of gain since late 2010.
	Sep CPI %yr	2.70%	2.60%	2.60%	One-off factors held up headline; core rate steady at 2.0% Jul-Aug
US	Oct NY Fed factory survey	6.3	8	-2.0	Debt ceiling threat in 2011 coincided with sub-0 readings.
Can	Sep house prices %yr	2.30%	-	-	Teranet/National Bank index growth rate picking up again.
Wed 16					
NZ	GlobalDairyTrade auction	2.40%	-	-	Strong Chinese demand has kept dairy prices at high levels.
	Q3 consumer prices	0.20%	0.80%	0.90%	A spike in fuel prices will help to lift annual inflation back above 1%.
Aus	Aug Westpac-MI Leading Index	4.10%	-	-	Monthly components look to be mostly softer in Aug.
Eur	Sep CPI %yr final	1.1% a	1.10%	1.10%	Flash report includes core which fell to 1.0%yr in Sep, a 3yr low.
	Aug exports	-1.6%	-	0.50%	German exports rose 1% in Aug; July was revised to smaller fall.
UK	Sep unemployment ch'	-33k	-25k	-35k	Benefit claimants plunging despite slower jobs growth this year.
US	Oct NAHB housing market index	58	57	55	Upswing in confidence at risk from mortgage rates and politics.
	Aug TIC data, \$bn	31.1	-	-	Net long-term TIC flows.
	*Sep CPI	0.10%	0.20%	0.10%	Gasoline prices fell in Sep, but PPI food price pressures a risk.
	*Sep CPI core	0.10%	0.20%	0.10%	Downside risk from apparel, OER (rent), medical care.
	Fed beige book	-	-	-	Prepared ahead of the next FOMC meeting at the end of the month.
	Fedspeak	-	-	-	George.
Can	Aug manufacturing sales	1.70%	0.20%	-	Sales have recovered from Mar-April weakness.
Thu 17					
Aus	Q3 NAB business confidence	-	-	-	Provides more detail around CAPEX.
Eur	Aug current account €bn sa	16.9	-	-	€24bn record surplus in March; recall was in deficit in 2011!
	Aug construction output	0.30%	-	-0.2%	Construction fell 1.9% in Aug in Germany after a 2.7% July gain.
UK	Sep retail sales inc fuel	-0.9%	0.40%	1.20%	Food & household goods to drive Sep bounce. CBI survey solid.
US	Initial jobless claims w/e 11/10	374k	-	330k	Unwind of Calif. systems distortion; still some impact from shutdown
	*Sep housing starts	0.90%	2.10%	3.00%	Starts pace for (single-family dwellings) still down 3.7% on Feb, but
	*Sep building permits	-2.9%	1.00%	3.00%	back in line with permits pace. See text box.
	Sep industrial production	0.40%	0.40%	0.70%	Factory hours worked not available. See text box.
	Oct Philadelphia Fed factory survey	22.3	16	-2.0	Debt ceiling threat in 2011 coincided with temporary sub-0 reading.
	Fedspeak	-	-	-	Fisher, Evans and George.
Fri 18					
Aus	RBA Head of Fin. Stability Ellis speaking	-	-	-	Topic TBA; 11.10pm AEDT, Sydney.
	RBA Governor Stevens speaking	-	-	-	Topic TBA; 12.00pm AEDT, Sydney.
Chn	Sep industrial production %yr	10.4	10.2	-	Basic materials & machinery inventories both lean.
	Sep fixed investment %ytd	20.3	20.3	-	Real estate & infra. both sound, manuf. to renew slowdown.
	Sep retail sales %yr	13.4	13.4	-	Auto sales modest, confidence measures subdued.
	Q2 GDP %yr	7.5	7.8	7.7	Activity firmed on the back of heavy industry.
US	Sep leading indicators	0.70%	0.60%	0.20%	Q3 shaping up as strongest for LEI since dud strong signal in Q4 11
	Fedspeak	-	-	-	Evans, including media Q&A.
Can	Jun CPI %yr	1.10%	1.00%	-	BoC core rate off its 1% lows earlier this year.

*These US data releases will be delayed for the duration of the government shutdown.

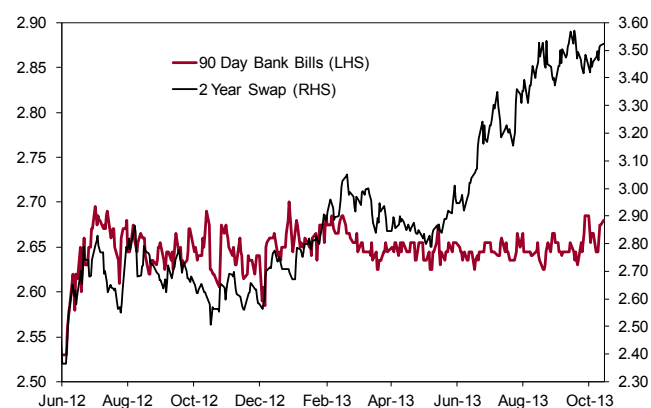


New Zealand forecasts

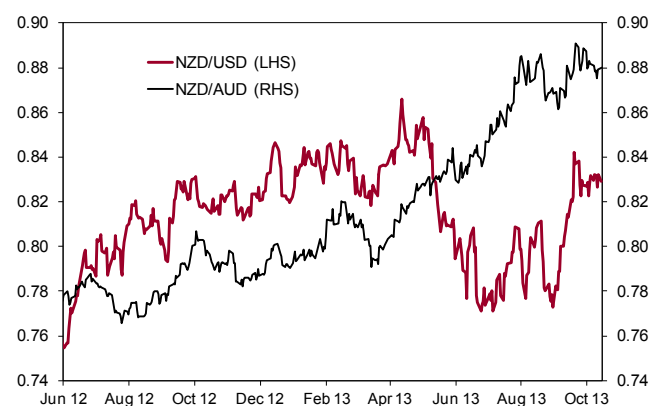
Economic Growth Forecasts	March years				Calendar years			
	2012	2013f	2014f	2015f	2011	2012	2013f	2014f
% change								
GDP (Production) ann avg	1.9	2.7	3.0	3.8	1.4	2.7	2.8	3.8
Employment	1.0	0.4	2.5	2.8	1.5	-1.4	3.7	2.8
Unemployment Rate % s.a.	6.8	6.2	5.6	4.8	6.3	6.8	5.8	4.8
CPI	1.6	0.9	1.4	2.3	1.8	0.9	1.4	2.1
Current Account Balance % of GDP	-3.8	-4.5	-4.4	-5.4	-3.6	-4.7	-4.2	-5.4

Financial Forecasts	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15
Cash	2.50	2.75	3.00	3.25	3.50	3.75
90 Day bill	2.75	3.00	3.25	3.50	3.75	4.00
2 Year Swap	3.50	3.70	3.80	3.90	4.10	4.20
5 Year Swap	4.40	4.45	4.50	4.60	4.70	4.80
10 Year Bond	4.40	4.50	4.60	4.70	4.75	4.80
NZD/USD	0.83	0.84	0.82	0.79	0.77	0.76
NZD/AUD	0.87	0.90	0.91	0.91	0.90	0.90
NZD/JPY	81.3	81.5	78.7	75.1	71.9	71.1
NZD/EUR	0.63	0.64	0.64	0.64	0.64	0.63
NZD/GBP	0.53	0.53	0.51	0.51	0.50	0.48
TWI	77.7	78.8	77.9	76.5	74.8	74.2

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on Monday 14 Oct 2013

Interest Rates	Current	Two weeks ago	One month ago
Cash	2.50%	2.50%	2.50%
30 Days	2.65%	2.64%	2.64%
60 Days	2.67%	2.66%	2.65%
90 Days	2.68%	2.69%	2.66%
2 Year Swap	3.52%	3.44%	3.57%
5 Year Swap	4.49%	4.36%	4.55%

NZ foreign currency mid-rates as at Monday 14 Oct 2013

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.8291	0.8270	0.8134
NZD/EUR	0.6114	0.6136	0.6114
NZD/GBP	0.5189	0.5132	0.5122
NZD/JPY	81.44	80.69	80.79
NZD/AUD	0.8802	0.8889	0.8778
TWI	77.02	77.03	76.45



Economic and Financial Forecasts

Economic Forecasts (Calendar Years)	2009	2010	2011	2012	2013f	2014f
Australia						
Real GDP % yr	1.4	2.5	2.4	3.7	2.5	2.3
CPI inflation % annual	2.1	2.8	3.0	2.2	2.1	2.7
Unemployment %	5.6	5.2	5.2	5.4	6.1	6.7
Current Account % GDP	-4.2	-2.9	-2.3	-3.7	-2.6	-3.0
United States						
Real GDP %yr	-3.1	2.4	1.8	2.8	1.5	1.7
Consumer Prices %yr	-0.3	1.6	3.1	2.1	1.4	1.6
Unemployment Rate %	9.3	9.6	8.9	8.1	7.6	7.5
Current Account %GDP	-2.7	-3.0	-2.9	-2.7	-2.5	-2.7
Japan						
Real GDP %yr	-5.7	4.9	-0.5	1.9	1.9	2.4
Consumer Prices %yr	-1.3	-0.7	-0.3	0.0	-0.2	0.1
Unemployment Rate %	5.2	5.1	4.5	4.3	4.3	4.3
Current Account %GDP	2.8	3.6	2.0	2.1	2.0	2.0
Euroland						
Real GDP %yr	-4.4	1.9	1.6	-0.6	-0.5	-0.1
Consumer Prices %yr	0.3	1.7	2.7	2.2	1.4	1.2
Unemployment Rate %	9.5	10.0	10.1	11.7	12.4	13.0
Current Account %GDP	-0.2	-0.1	0.0	0.9	1.0	1.0
United Kingdom						
Real GDP %yr	-4.0	1.8	0.9	0.2	1.1	0.9
Consumer Prices %yr	2.2	3.2	4.0	2.8	2.3	1.8
Unemployment Rate %	7.6	7.8	8.4	8.0	8.5	8.5
Current Account %GDP	-1.3	-2.5	-1.9	-3.8	-2.5	-1.5

Forecasts finalised 7 October 2013

Interest Rate Forecasts	Latest	Dec 13	Mar 14	Jun 14	Sep 14	Dec 14
Australia						
Cash	2.50	2.50	2.25	2.00	2.00	2.00
90 Day Bill	2.60	2.60	2.35	2.10	2.10	2.10
10 Year Bond	4.13	3.75	3.60	3.40	3.80	4.00
International						
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond	2.68	2.35	2.40	2.40	2.80	3.00
ECB Repo Rate	0.50	0.50	0.50	0.50	0.50	0.50
Exchange Rate Forecasts						
AUD/USD	0.9477	0.95	0.93	0.90	0.87	0.85
USD/JPY	98.49	97	96	95	94	93
EUR/USD	1.3536	1.36	1.33	1.28	1.23	1.20
AUD/NZD	1.1425	1.14	1.11	1.10	1.10	1.10

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Disclaimer continued

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